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C O N F I D E N T I A L SECTION 01 OF 02 QUITO 002380

SIPDIS

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SUBJECT: PROGRESS ON OCCIDENTAL CASE

REF: QUITO 2327

Classified By: CDA Frank Ledahawsky Reason 1.5 (b) and (d)

1. (SBU) Summary. Occidental Petroleum (Oxy) and Embassy efforts to tone down the rhetoric and reach an amicable resolution with the GOE are starting to pay dividends. Oxy had a productive meeting with the Procurador (Solicitor General). President Gutierrez has selected a commission, comprised mostly of rational members, to address the latest accusations by the Procurador and Oxy's international arbitration with the GOE. The Procurador said he would not link the two issues and has reportedly agreed to say nothing further in the press on the Oxy case. Oxy is pleased with the progress that has been made over the last few days. End Summary.

Progress with the Procuraduria

2. (SBU) Oxy's President and GM for Ecuador Jerry Ellis met with Procurador General Jose Maria Borja on August 24. Ellis described the meeting as cordial and productive. The following day, Econ Counselor met with attorneys from the Procuraduria (Solicitor General's Office). Oxy asserts that its transfer of 40% of its Block 15 rights to Canadian Oil Company EnCana has not been completed. The Procuraduria cites an October 1, 2000 agreement with City Investing Company Ltd. (at that time EnCana's subsidiary operating in Ecuador) and a November 1, 2000 "Farmout Agreement" that was filed with the US Securities and Exchange Commission (SEC) to support its allegation that the transfer was completed in 2000. Press reports refer to several SEC filings by Oxy that purportedly confirm the transfer.

3. (SBU) The Procurador's representatives told us that it is not their desire to have the GOE cancel Oxy's Block 15 participation contract and take over Oxy's Block 15 assets. Still, they asserted, the law could not be ignored. In press statements, the Procurador has said he will not only look at Oxy, but will also review the contracts of all oil companies operating in Ecuador, starting next with EnCana.

4. (C) On August 25, the Procuraduria officially notified Minister of Energy and Mines Eduardo Lopez of the violations, stating they were grounds for the termination (caducidad) of Oxy's Block 15 contract. Attorneys for the Procuraduria told EconCouns August 25 that the Procuraduria would make no more public comments on the issue, now that it is in the hands of the MEM. They also said that the Procurador would not link the alleged hydrocarbon law violations with Oxy's \$75 million value added tax (VAT) international arbitration case, currently under appeal at the Queen's Court in London. The Procurador's representatives told us that given Ecuador's Director of Internal Revenue Service (SRI) Elsa de Mena's public admission that the SRI owed Oxy at least \$55 million in VAT drawbacks, even if the GOE won the appeal, it would make arrangements with Oxy for payment of that amount. If the GOE lost the VAT case appeal, they said the GOE would meet its obligation to pay the \$75 million in full.

Case Generates Lots of Attention

5. (SBU) The press has widely publicized the case. Numerous articles and electronic media have expressed support for the Procurador and some criticize the international arbitration decision for allegedly ignoring the cases pending in Ecuadorian courts on the same issues. Members of Congress, many of whom are already critical of private investment in the oil sector, have been quick to urge the cause against Oxy and the Procurador's investigations of other foreign oil companies. In the meeting with Procuraduria staff, EconCouns emphasized the importance of reducing the quantity and tone of rhetoric on the issue. In past cases in Ecuador the negative rhetoric had gotten out of control and the Government had painted itself into a corner. Procuraduria staff acknowledged that this was a danger, but said that their boss had issued an order to his press staff that morning to stop making statements, and had said that he had made his last public pronouncements on the subject, for now.

Oxy's Reaction

16. (C) Oxy admits that it could have handled the transfer to EnCana better (reftel) and that it has violated the hydrocarbon law on a number of occasions (providing a list of 51 possible violations to Econoffs, 17 more than originally cited by the Procuraduria and in press reports). As to the other violations of the hydrocarbon law, Oxy notes that it has complied with all requests from the MEM and where Oxy has violated the law it has paid the statutory fine.

17. (C) Ellis has repeatedly told Econoffs that Oxy is willing to sit down with the GOE to discuss the alleged hydrocarbon law violations and Oxy's VAT arbitration award. Oxy views the August 26 formation of a commission composed of the Procurador, Ministers of Economy and Energy, a representative from the Corruption Commission, and two well-respected private sector representatives, Walter Spurrier and Galo Garcia Ferrat, as another positive development. Oxy headquarters representatives will likely visit Quito next week to begin discussions.

18. (C) Oxy headquarters lawyers called EconCouns on August 26 to discuss the case and review the names of new counsel they intend to contract to work on this issue. EconCouns recounted the meeting with Procuraduria lawyers, updated them on the formation of the commission, and provided background information on the lawyers they are considering hiring.

Comment

19. (C) Post's messages to the GOE about the gravity of the Procurador's (over) reaction to the Oxy transfer and other violations and the potential ramifications for ATPDEA benefits, FTA negotiations and other USG support are sinking in with the GOE. Procuraduria representatives' statement that they have no desire to see Oxy's contract cancelled or Oxy leave Ecuador, a statement echoed by other members of the GOE, appears to be a result of the forceful position we have taken. Oxy's willingness to sit down with the GOE to discuss the issues is also encouraging.

110. (C) This latest crisis could be turned into an opportunity to not only resolve current issues, but also address additional development/foreign investment in the oil sector. The MEM announced August 26 the discovery of 4.6 billion barrels in new reserves in the Ishpingo-Tambococha-Tiputini (ITT) fields. However, there is also a risk, albeit small at this point, that the attention of the press and the Congress could put added pressure on the weak Gutierrez administration, making it more difficult to resolve the crisis in a quiet and amicable manner.
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